No. 14,821

IN THE

United States Court of Appeals

For the Ninth Circuit

KARL W. LINES,

Appellant,

vs.

FALSTAFF BREWING CO., et al.,

Appellees.

APPELLANT'S REPLY BRIEF.

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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1. SECTION 44(a) OF THE BANKRUPTCY ACT.

Because section 44(a) of the Bankruptcy Act (11 U.S.C.A., §72(a)) disqualifies certain creditors from voting for a trustee, the appellees contend that a referee no longer has supervisory power to disqualify other creditors from such voting. (Brief for Appellees, 3-4, 13.) Obviously, section 44(a) does not purport to exhaust the list of disqualified creditors, for other sections of the Bankruptcy Act also enumerate disqualified creditors. In that connection it is enough to refer to section 56 of the Act (11 U.S.C.A., §92) having reference to secured creditors.

The real question here, of course, is whether the referee had supervisory power, on equitable grounds,

to disqualify creditors other than those enumerated in said section 44(a) or other sections of the Act. That question was left open by this court in *West Hills Memorial Park v. Doneca,* 9 Cir. 1942, 131 F. 2d 374, where an order appointing a trustee was affirmed. But in the earlier case of *Wilson v. Continental Building & Loan Assn.,* 9 Cir. 1916, 232 F. 824, this court unmistakably held that a bankruptcy court had supervisory power, on equitable grounds, to disqualify certain creditors from voting for a trustee. In affirming an order disqualifying such creditors, it was there said, at page 827:

> "(1) The petitioners invoke the general right of creditors to appoint a trustee of the bankrupt estate, and while admitting that the appointment is, by General Order 13 . . . subject to approval or disapproval by the referee, they argue that action by the referee is not to be exercised arbitrarily, but only for cause. There can be no dispute with this general rule. All must agree that the vital interest which creditors have in the preservation and wise management of the estate of the bankrupt must, as a general rule, make them the best judges of who shall be appointed as trustee, and their selection cannot be arbitrarily ignored. *But the Supreme Court, in the exercise of its power to make general orders in bankruptcy, foresaw that instances might arise where, notwithstanding the desire of the creditors for the selection of some particular person as trustee, the best interests of the estate would not be served by allowing such choice to stand, and they reserved a supervisory power in the referee or judge.*" (Emphasis added.)

The supervisory power of a referee to equitably control the election of a trustee was confirmed in *Austin Resort & Land Co.,* D.C.Cal. 1935, 12 F. Supp. 459, the court saying, at page 463:

> "A court of bankruptcy is a court of equity; * * *
>
> (4, 5) There is nothing in the Bankruptcy Act making the selection of a trustee by the creditors absolute at all events. Proceedings in bankruptcy are flexible and liberal and in their major aspects administrative. Such proceedings are intended to be and usually are carried out informally. * * * (6) . . . But it is the settled practice of this court not to disturb the acts of the referee 'in administrative matters—of which the election of a trustee is a typical example—unless a plain and injurious error of law or abuse of discretion is shown.' In re Rosenfield-Goldman Co. (D.C.) 228 F. 921, 923."

And the supervisory power of a referee to equitably disqualify certain creditors was upheld in *In re Stowe,* D.C.Cal. 1916, 235 F. 463, where it was said, at page 464:

> "There is no disposition on the part of the court to prevent the creditors of a bankrupt from selecting a trustee. But when some of the creditors knowingly join with the attorney of an assignee, whose interests are adverse to the interests of all the creditors of the bankrupt, in an endeavor to control the selection of the trustee, in which endeavor the bankrupt himself participates, the creditors who do not participate in such endeavor are entitled not to be left helpless in the face of such a union. The theory of the bank-

> rupt law is that the assets of a bankrupt shall be honestly collected and honestly distributed among all the creditors. Neither the bankrupt himself, nor his attorney, nor an assignee, nor his attorney, can be permitted to control the selection of a trustee. If creditors knowingly join with the bankrupt or his attorney, or with an assignee or his attorney, in an effort to do what it has repeatedly been decided they may not do, the simplest and most obvious way to defeat their purpose is to reject their selection of trustee, and permit the creditors who are not in the combination to make the selection. That was done in the present instance and the action of the referee is affirmed."

The case of *In re Stowe,* just cited, was cited with approval in *Schwartz v. Mills,* C.A. 2d N.Y. 1951, 192 F. 2d 727, 730, in support of the statement that "a trustee should not owe his selection to those whom he must sue for restoration of the bankrupt's estate".

Another contention in the brief for appellee (page 4) is that the abrogation of General Order 13 in February of 1939 deprived referees of supervisory power, on equitable grounds, over the election of trustees. This rather startling contention is made despite the fact that the Chandler Amendments modernizing the Bankruptcy Act in 1938 greatly increased the powers of referees. There is no merit whatever in the contention. General Order 13 was abrogated in 1939 for the very simple reason that "it was superfluous in view of the specific provisions in the Bankruptcy Act conferring jurisdiction upon the court to approve the

appointment of trustees". (6 Am. Jur. 911, §631, Note 10.) Section 1(9) of the Act (11 U.S.C.A. §1(9)) provided that " 'Court' shall mean the judge or the referee of the court of bankruptcy in which the proceedings are pending". Section 2(a)(17) of the Act (11 U.S.C.A., §11(a)(17)) invested courts of bankruptcy with jurisdiction "at law and in equity" to "Approve the appointment of trustees by creditors or appoint trustees when creditors fail so to do; and, upon complaints of creditors or upon their own motion, remove for cause receivers or trustees upon hearing after notice". It is elementary that "Jurisdiction to approve necessarily includes jurisdiction to disapprove an appointment". (6 Am. Jur. 911, §631.) And that it was not the intention of the Act to deprive referees of any of their powers existing at the enactment of the Chandler Amendments of 1938 is clearly indicated by section 2(b) of the Act (11 U.S.C.A., §11(b)) which provides:

> "(b) Nothing in this section contained shall be construed to deprive a court of bankruptcy of any power it would possess were certain specific powers not herein enumerated."

That the referee in the present case had supervisory power, in equitable grounds, to disqualify creditors from voting for a trustee, is therefore plain.

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2. EQUITABLE GROUNDS.

The referee was convinced, in the light of all the circumstances before him, that it was not for the best

interest of all the creditors of the bankrupt, and particularly those who were not members of the Board of Trade, that a Board of Trade sponsored candidate be elected trustee. He made his finding accordingly. (T. 33.) All of the business assets of the bankrupt, amounting to $4045.88, had been assigned to the Board of Trade and such assets were in its possession. The claims of creditors amounted to $26,107.14. (T. 19.) Of this amount, a claim in the sum of $13,824.33 was held by relatives of the bankrupt. The claims held by members of the Board of Trade amounted to $4508.67. (Brief for Appellee 1.) It was not at all improbable that a Board of Trade sponsored trustee would favor those electing him or be subject to influence from them. It was not at all improbable that a controversy over the business assets in the hands of the Board of Trade might develop. In disqualifying the Board of Trade sponsored creditors, the referee exercised a sound discretion on equitable grounds. That discretion should not be disturbed.

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3. REVIEW OF DISCRETION.

In *Morris Plan Industrial Bank v. Henderson,* 2 Cir. 1942, 131 F. 2d 975, it was said, at pages 976 and 977:

> "(1, 2) The first question is as to the extent of our review: whether the case comes before us as it came before the district judge, or whether he had a larger latitude in reviewing the referee's

findings than we have. General Order 47, 11 U.S. C.A. following section 53, requires the judge to 'accept his (the referee's) findings of fact unless clearly erroneous.' These are the same words as those used in Rule 53(e)(2), 28 U.S.C.A. following section 723c, and substantially the same as those in Rule 52(a) which requires us not 'to set aside' the finding of a judge unless it too is 'clearly erroneous.' It is true that logically a distinction can be drawn between holding a referee's finding to be 'clearly erroneous' and holding a judge's finding that a referee's finding is 'clearly erroneous' to be 'clearly erroneous.' Possibly the Seventh Circuit meant to make that distinction in a case that arose under General Order 47 before it was amended. In re Duvall, 103 F. 2d 653. We should regret, however, to be compelled now to introduce such refinements into the solution of what is after all only a practical problem. Everyone forms his conclusions from testimony, not only from the words which he hears the witnesses utter but from their appearance when they utter them; and the added weight to be attached to a referee's finding, or to a judge's (if he sees the witnesses) depends upon the fact that he has in effect had evidence before him which cold print does not preserve. So far, therefore, as the words themselves leave any latitude, the referee's conclusion ought to prevail because we cannot appraise the cogency of the lost evidence. In the end, as we have often said, the responsibility for the right conclusions remains the judge's as indeed it does ours; In re Kearney, 2 Cir. 116 F. 2d 899; but we have again and again held that except in plain cases we should accept the referee's findings. (Citations.) We therefore

hold that the question is the same in this court as it was in the district court."

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4. APPELLEES' CASES.

Without exception, the cases cited by appellees (pp. 7-12) were all decided long before the enactment of the Chandler Amendments to the Bankruptcy Act in 1938. Each was decided at a time when the powers of a referee were much less than they now are. Each turns on a set of facts factually different from the facts and circumstances upon which the referee acted in this case. Some of the appellees' cases are inconsistent with the cases cited by appellant from the decisions in this circuit. The case of *In re Harris Construction Company,* 37 F. 2d 951, at the head of appellees' list, involved a set of facts where the referee disregarded all nominations for trustee and summarily made an appointment. Appellees cite *In re Bay Pakaway Haberdashers & Hatters, Inc.,* 59 F.2d 103. (p. 7.) It does not appear in 59 F. 2d.

Finally, appellees point out that appellants made no complaint about the ability or integrity of candidate England. (p. 12.) As said in *In re Bloomberg,* D.C.Minn. 1931, 48 F. 2d 635, "the complaint is not against him, but against the method used in securing his appointment".

CONCLUSION.

Appellant therefore again respectfully submits that the order appealed from should be reversed with direction to the District Court to affirm the order of the referee.

Dated, San Francisco, California,
March 7, 1956.

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Attorney for Appellant.